FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

No. .....

JOSEPH E. SWANSON, et al., As Trustees of the LAKE VIEW LAND ASSOCIATION,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI

TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

and

BRIEF IN SUPPORT THEREOF

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

Petitioners pray that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit, entered on April 10, 1935 (R. 47), affirming the judgment of the United States Board of Tax Appeals in the case entitled as above, being No. 5280 in said Court.

QUESTION PRESENTED

This case involves the distinction between a trust which is subject to income tax as a fiduciary, under Section 219

of the Revenue Act of 1926, and one which is an "association" under Section 2 (a) (2) of the Revenue Act of 1926 and is therefore subject to income tax as a corporation.

The specific question is whether two owners of a three-story apartment building, in which one of them lived, who transferred title to themselves and another as trustees, created an "association," which is taxable as a corporation, where the building was managed by one of the owners, as a partner of the real estate management firm which was employed as the agent for the trustees, in consultation with the other owner. During the taxable years here involved, the beneficial owners were the wives of the original owners.

Reasons for Granting This Petition

(1) An important Federal question has been decided in this case contrary to the applicable decisions of the Supreme Court. The Circuit Court of Appeals for the Seventh Circuit has given to the statutory term "association," a construction substantially at variance with that established by this Court in:

Hecht v. *Malley*, 265 U. S. 144.

Burk-Waggoner Oil Association v. *Hopkins*, 269 U. S. 110.

(2) This decision of the Circuit Court of Appeals for the Seventh Circuit is in direct conflict with the decisions of the Circuit Courts of Appeals for several other Circuits, holding that trusts were not taxable as associations, in the following cases:

Coleman-Gilbert Associates v. *Commissioner*, First Circuit, February 27, 1935, 76 Fed. (2d)

191, reversing the Board of Tax Appeals. Petition for certiorari filed in this Court, May 27, 1935, Nos. 1003, 1004. Some twenty apartment houses were operated by the trustees.

Commissioner v. *Kelley,* First Circuit, December 1, 1934, 74 Fed. (2d) 71, affirming Board of Tax Appeals. Trustees conducted an active manufacturing business under the name of Union Paste Co.

Commissioner v. Guitar Trust Estate, Fifth Circuit, August 24, 1934, 72 Fed. (2d) 544, reversing Board of Tax Appeals on other grounds but sustaining its holding that a trust managing large tracts of real estate and much personal property and carrying on a ranching business, a cotton business, and a cotton seed business, was not taxable as an association.

Commissioner v. *Combs,* Ninth Circuit, April 11, 1935, ... Fed. (2d) ....., affirming the Board of Tax Appeals. The trust was created to develop an oil lease and operated the well for about two years.

Commissioner v. *Brouillard,* Tenth Circuit, April 4, 1934, 70 Fed. (2d) 154, certiorari denied under title of *Helvering* v. *Pryor & Lockhart Development Co.,* October 8, 1934, ... U. S. ....., affirming the decisions of the Board of Tax Appeals. Three oil development syndicate trusts.

(3) In the Seventh Circuit alone, several decisions of the Circuit Court of Appeals upon the same question are in irreconcilable conflict, and demonstrate that no consist-

ent rule is being applied by that Court. These decisions are:

I. Trusts Held Not To Be Associations.

Tyson, et al., *Trustees of Zenith Real Estate Trust* v. *Commissioner*, December 9, 1931, 54 Fed. (2d) 29, reversing Board of Tax Appeals. Trustees holding net lease of business property.

Commissioner v. *Morriss Realty Co. Trust*, January 2, 1934, 68 Fed. (2d) 648, affirming Board of Tax Appeals. A family real estate trust, which subdivided tracts of land, including some which it purchased, sold lots on installments, erected houses and sold them on time contracts, and borrowed money on mortgages for such operations.

Commissioner v. *McCormick, et al.*, January 24, 1934, 68 Fed. (2d) 653, affirming Board of Tax Appeals. Trustees owning a large office building, operated by a managing agent.

Commissioner v. *Duckwitz*, Feb. 9, 1934, 68 Fed. (2d) 629, affirming Board of Tax Appeals. Trust organized to obtain capital for development of oil wells, procured the drilling of three wells, operated them, and then sold the property.

II. Trusts Held To Be Associations.

Tyson, et al., *Trustees of Chicago Real Estate Trust* v. *Commissioner*, December 15, 1933, 68 Fed. (2d) 584, certiorari denied June 4, 1934, 292 U. S. 657, affirming Board of Tax Appeals.

Trustees holding three office building properties under net leases, having previously owned and sold other properties.

Reinecke v. *Kaempfer*, et al., June 26, 193[illegible] 72 Fed. (2d) 469, certiorari denied Jan. 21, 1935, ... U. S. ....., reversing District Court. Family trust, operating bird store.

(4) The question involved is of great general interest, affecting a large number of taxpayers and involving large amounts of taxes. The controlling rule originally announced by this Court has been applied by the Circuit Courts of Appeal with inconsistency and contradiction. In their own opinions, these Courts declare that there is no controlling rule, and that it is difficult for them to discover the standards which they are to apply. This creates an intolerable condition of uncertainty, with the result that an unduly large proportion of the decisions of the Board of Tax Appeals upon this question are appealed. Many of such cases are now pending before the Circuit Courts of Appeals. There results also a condition of intolerable inequality, in that two taxpayers, similarly situated, are subjected to different liabilities, because one lives in a circuit where the rule, or, rather, the unexpressed attitude, is favorable, while the other lives in a circuit where the attitude is unfavorable.

Certiorari was granted by this court on May 13, 1935, in the case of *Morrissey* v. *Commissioner*, Dkt. No. 834, and petition for certiorari has been filed on May 27, 1935, in the case of *Helvering* v. *Coleman-Gilbert Associates*, Dkt. Nos. 1003, 1004, by the Solicitor General of the United States. These cases involve the same question as the present case.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Seventh Circuit should be granted.

ARNOLD R. BAAR,
Attorney for Petitioners.

Chicago, Illinois, May 29, 1935.

BRIEF.

(1) The Decision In This Case Is In Conflict With The Controlling Decisions of This Court.

The opinion of the Circuit Court of Appeals for the Seventh Circuit in this case shows that the Court has departed widely from the rule announced many years ago by this Court. In holding that the Lake View Land Association was taxable as a corporation, the Court has given to the statutory term "association" a construction substantially at variance from that prescribed by the Supreme Court in the following cases.

In *Hecht* v. *Malley*, 265 U. S. 144, 157, this Court said that the word "association" signifies—

> "* * * a body of persons united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise."

And further—

> "* * * a body of persons organized for the prosecution of some purpose, without a charter, but having the general form and mode of procedure of a corporation."

In *Burk-Waggoner Oil Association* v. *Hopkins*, 269 U. S. 110, 113, 114, this Court has also pointed out that associations were properly subject to the taxes imposed upon corporations because of their practice to "manage their affairs by a board of directors and executive officers and conduct their business in the general form and mode of

procedure of a corporation," and "because of this resemblance in form and effectiveness to the ordinary business corporation."

It was pointed out by the Supreme Court in *Hecht* v. *Malley*, 265 U. S. 144, not only that the Massachusetts trusts there involved employed many corporate forms and methods of procedure, but in addition that, under the Massachusetts statutes, they were classified as "associations" and were subject to suit, attachment and execution as if they were corporations. The opinion states, at page 147:

> "The Massachusetts statutes, however, recognize their existence, and impose upon them, as associations,' certain obligations and liabilities.[4]
>
> "[Footnote to opinion:] '[4] By Chapter 441 of the Acts of 1909, the trustees of 'a voluntary association' under a written instrument or declaration of trust the beneficial interest of which is divided into transferable certificates of participation or shares' are required to file copies of the instrument of trust with designated public officers; and by chapter 184 of the Acts of 1916, such associations may be sued for debts, obligations, or liabilities, and their property may be subjected to attachment and execution as if they were corporations. See 2 General Laws 1921, chap. 182."

Again, at page 161, the Court said:

> "* * * We do not believe that it was intended that organizations of this character—described as 'associations' by the Massachusetts statutes and subject to duties and liabilities as such—should be exempt from the excise tax on the privilege of carrying on their business * * *."

The specific emphasis upon this element of the case, as well as the general language of the opinion, clearly indicates that the Supreme Court would not have held those

trusts taxable as corporations in the absence of their substantial resemblance to corporations. This position was later restated unequivocally in *Burk-Waggoner Oil Association* v. *Hopkins*, 269 U. S. 110, as quoted above. As disclosed by the opinion in the present case, as well as by its other decisions upon the same question, the Circuit Court of Appeals for the Seventh Circuit has completely departed from the rule thus established by the Supreme Court.

In the opinion below, there is no attempt to specify those corporate forms and methods of procedure which were employed by this trust. The Court does make the general statement that this trust was "a corporation in everything but the name and seal and the fact that its business was carried on without holding formal meetings, adopting resolutions, and keeping minutes." The preceding statement of facts by the Court, however, fails to disclose even one essential corporate characteristic which was present in this case. On the contrary, it shows that in many respects there was not the slightest resemblance to the methods and forms and modes of procedure used by corporations, and that the methods and forms and modes of procedure were those traditionally employed by trusts and trustees. The opinion does not point out a single feature in which this trust was not a typical real estate holding trust. For convenience, the Court's statement of the facts is here reprinted in full (the footnotes having been supplied).

> "Joseph E. Swanson and Ralph C. Otis were the owners of a three-story apartment building containing nine apartments. On June 1, 1915, they entered into a trust agreement for the purpose of carrying the title to the real estate. The first trustees were Ralph C. Otis, Joseph E. Swanson, and Allen G. Mills. In 1926, James Otis succeeded his father as trustee.
>
> "Under the trust agreement, the trustees were given the complete management and control of the property,

to exchange, reconstruct, remodel, sell or improve at their discretion or to borrow money secured by the property. They were authorized to rent suitable quarters for the transaction of the business of the trust and employ such assistants as they required. The agreement provided for the issuance of 'receipts' to evidence the interests of the beneficiaries, representing 1,000 shares at the par value of $100 each. It was provided that the receipts were evidences of the ownership of personal property and not real estate. They might be transferred by assignment. Originally, one-half of the shares were issued to Otis and one-half to Swanson, who later transferred their interests to their wives, who owned the shares during 1925 and 1926. The agreement provided that the trust could sue and be sued;* that neither the trustees nor the beneficiaries should be personally liable** and that all persons dealing with the trustees must look only to the property of the trust; that it should be terminated at the expiration of twenty years after the death of the last survivor of certain named persons or by the trustees in their discretion at any time before the expiration of the twenty years by selling all the property held by them as such and distributing the net proceeds of such sale. The trust had succession and was not terminated by the death of a trustee or beneficiary. * * *

"The trustees of the Lake View Land Association never assembled in formal meetings, never adopted resolutions or took formal action with reference to the

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* This must imply that the trustees could sue and be sued *as individuals*, and not the trust as an entity, as that would not be sanctioned by the law of Illinois. *Wahl* v. *Schmidt*, 307 Ill. 331, 138 N. E. 604.

** This provision would be without legal effect in Illinois, in that the trustees would nevertheless remain personally liable, with a claim for reimbursement from the trust estate. *Austin* v. *Parker*, 317 Ill. 348, 148 N. E. 19.

affairs of the property, kept no minute book, had no by-laws. They elected no officers and had no so-called board of directors."

The Court quotes from its prior decision in the case of *Tyson*, et al., *Trustees of Chicago Real Estate Trust* v. *Commissioner*, 68 Fed. (2d) 584, certiorari denied 292 U. S. 657, to the effect that a trust is a quasi-corporate organization in form and procedure, and as such is taxable as a corporation, notwithstanding that its organization is of a very loose and informal character. In this present case, however, the Court does not make even the pretext which it did in the Tyson case, of showing wherein the organization or operation of this trust resembled to any degree those which are characteristic of corporations. Moreover, the complete opinion in the Tyson case itself will demonstrate that the Court there rested its decision upon three grounds, of which the first was controlling, which the Court stated as follows:

(1) "We therefore conclude that the trustees were engaged in sufficient activities to warrant our holding that they were carrying on a business enterprise, hence taxable as an association."

(2) "An entity * * *, in order to bring itself within the definition of a trust for taxing purposes, must be practically self-operating, 'without care or supervision.'"

(3) "We think that these facts are sufficient to warrant our classifying petitioners as a quasi-corporate organization in form and procedure and as such, taxable as a corporation."

In the present opinion, the ground of decision would seem to be most definitely expressed in the following statements:

"The question therefore resolves itself into this: Can the trustees avoid the conclusion that they are

> carrying on a business enterprise by turning the management of their affairs over to one of their number as a partner in another enterprise which handles the affairs of the association with the advice of the other trustees? We believe the answer to be that the trustees in this case were an association carrying on a business enterprise, personally and through their agents and employees."

The conduct of a business, or the business character of the trust activities, was not even mentioned by the Supreme Court in the definitions above quoted, which refer only to "the prosecution of some common enterprise" and "the prosecution of some purpose." The rule has been correctly stated by the Circuit Court of Appeals for the Tenth Circuit in *Commissioner* v. *Brouillard*, 70 Fed. (2d) 154, as follows:

> "The fact that a group associate themselves together for the purpose of engaging in business for profit does not necessarily mean that they must be taxed as an association. That is not the decisive consideration."

The Circuit Court of Appeals for the First Circuit has also expressed the correct rule, in *Coleman-Gilbert Associates* v. *Commissioner*, Feb. 27, 1935, 76 Fed. (2d) 191, as follows:

> "We think, however, it is generally agreed that, in order for a trust to be taxed as a corporation, the trustees must not only be carrying on a business enterprise for profit, but must be doing it in much the same manner and form as directors of a corporation."

This "general agreement" has been ignored by the Circuit Court of Appeals for the Seventh Circuit, in holding in this case that this trust was taxable as a corporation in

the complete absence of the use of corporate methods and forms, as required by the rule established by the Supreme Court.

(2) This Decision Is In Conflict With Those Rendered in Four Other Circuits.

The facts of this case and the grounds of decision assigned by the Court have been set forth under the preceding point. With these in mind, a brief analysis of the most recent decisions in the four other Circuits and merely a slight examination of the rules of decision as stated in their opinions will disclose unmistakable and irreconcilable conflict.

Coleman-Gilbert Associates v. *Commissioner,* Feb. 27, 1935, 76 Fed (2d) 191, is a case in which the Circuit Court of Appeals for the First Circuit reversed the decision of the Board of Tax Appeals and held that no "association" existed. On behalf of the Commissioner, a petition for certiorari has been filed in this Court on May 27, 1935, Dkt. Nos. 1003, 1004, which alleges that the decision there rendered "is in substantial conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit" in the present case.

After having operated a number of jointly owned apartment houses for more than twenty years, three men and their wives created a trust which, during the taxable years involved, owned and operated "some twenty apartment houses," producing gross rentals of approximately $420,000.00 per year from about 1500 tenants. All of the interested parties were trustees. Two of them devoted their entire time to the management and operation of the trust properties and a third was "also actively engaged in taking care of a part of the management duties," but the two

wives were entirely inactive. No agents, excluding strictly supervised employees, were employed. The Court said:

> "From the decisions of the Board of Tax Appeals and the several Circuit Courts of Appeals, it is impossible to mark out any definite pathway to follow in every case. The only conclusion is that each case must depend on its own state of facts.
>
> "We think, however, it is generally agreed that, in order for a trust to be taxed as a corporation, the trustees must not only be carrying on a business enterprise for profit, but must be doing it in much the same manner and form as directors of a corporation. • • •
>
> "It is true that the Board of Tax Appeals found as facts that, while the trustees in the instant cases did not exercise all the powers given them in the trust instrument, they were, nevertheless, carrying on a business for profit in much the same manner as directors of a corporation are associated together with the purpose of carrying on a business enterprise; and upon these facts, judged by their activities, the Coleman-Gilbert Associates was an association within the meaning of Sec. 2 (2) (a) (2) of the 1926 Act, and 701 (a) (2) of the 1928 Act. • • •
>
> "From the activities of the trustees alone we do not think the Board was warranted in holding as a matter of law that the trust was an association. While there may have been sufficient evidence to warrant the Board in finding that they were conducting a business enterprise, and with the purpose of ensuring an income for the beneficiaries during the continuance of the trust, and while they may have exercised powers in some respects as great as those of the directors of a corporation, they did not exercise them in the manner of directors of a corporation. They held no meetings; they kept no records; their acts were not determined by a majority vote. Their tenure as trustees was during life or the duration of the trust, unless they voluntarily resigned. Two trustees were

wholly inactive, and a third only active in part in the management. They conducted the business in the same manner that it had been conducted before the trust was formed. * * *

"The uncontradicted evidence in these cases discloses, we think, that the Coleman-Gilbert Association was not organized to conduct a business for profit; that while the trustee did manage the property so that it produced an income for the beneficiaries, it was only incidental to the main purpose for which the trust was created. The purpose of the creators, according to the uncontradicted evidence, was to prevent a partition and division of the property in case one of the owners died within a definite period of time. * * *

"If every trust terminating in five, ten or fifteen years, in which the trust res consisted of rentable real estate is managed faithfully and prudently by the trustees with a view to producing the largest income for the *cestuis qui trustent*, is to be taxed as an association, few strictly pure trusts would escape a double taxation upon its income.

"The imposition of a double tax upon the income of a trust viz.: a tax, first, on the income of the trust as an entity, and a further tax upon the distributive shares of the beneficiaries, should clearly be warranted under the Acts of Congress, and should not have as its basis some remote resemblance to a corporation. If there is doubt, it should be resolved in favor of the taxpayer. * * *

"The conclusion which the Board drew from the stipulated facts and the uncontradicted evidence that Coleman-Gilbert Associates was an association within the meaning of the Revenue Acts of 1926 and 1928, we think, was error."

The application of these principles to the case of the Lake View Land Association would clearly require a different result. There is therefore a definite conflict between

the decisions in the First and Seventh Circuits, as recognized by the Solicitor General in his petition for certiorari in the above case. The present decision should therefore be reviewed by this Court as herein urged.

In another case before the same Court, *Commissioner* v. *Kelley*, December 1, 1934, 74 Fed. (2d) 71, affirming the Board of Tax Appeals, the Circuit Court of Appeals for the First Circuit reached a similar result upon similar grounds. It was there held that trustees conducting an active manufacturing business under the name of Union Paste Co. were not taxable as an association, for reasons stated as follows:

> "While the powers of the trustees under the declaration of trust were broad and the form of organization authorized in the declaration of trust was similar in many respects to that of a corporation, the trustees never exercised these powers. • • •
>
> "While the trust here involved can be said to be an organized body without a charter, the main issue, as we view it, is not whether they conducted a business and for profit, but whether they conducted such business from 1925 to 1930 'upon the methods and forms used by incorporated bodies,' or as an organization 'having the general form and mode of procedure of a corporation.' • • •
>
> "In the first place it is admitted that the sole purpose in organizing the trust was a temporary one, viz.: to bring to a conclusive binding determination the interest of Helen W. Kelley in the income of the enterprise. The government seeks to distinguish between motive and purpose; but while the motive for the creation of this trust was the demand of Helen W. Kelley for an accounting, the purpose of creating the trust is admitted to have been to secure a conclusive, binding determination of her interest, and, incidentally, during the pending litigation, to conduct the business along the same lines as under the partnership, with the trustees having full control.

> "To constitute a trust an association and taxable as a corporation, there must be a body of persons associated together who are (1) actually carrying on business for profit, and (2) under the usual forms and procedure of corporations. Both conditions must be present."

In *Commissioner* v. *Guitar Trust Estate*, August 24, 1934, 72 Fed. (2d) 544, the Circuit Court of Appeals for the Fifth Circuit reversed the decision of the Board of Tax Appeals upon other grounds but sustained its decision that the trust was not taxable as an association, under the following circumstances. A husband and wife transferred substantially all their property to the husband and two of his sons, as trustees for the benefit of the grantors and their eight children. The property consisted of large tracts of Texas real estate and much personal property, including a ranching business, a cotton business, and a cotton seed business, all of which were conducted by the trustees. No certificates of beneficial interest were provided for or issued. The beneficiaries, other than the three trustees, took no part in the affairs of the trust. The Court said:

> "Except that the trustees were authorized to continue the going business, the trust had no feature in common with a corporation. The very purpose of creating a trust is to have the property administered by trustees for the beneficiaries. It is not unusual that this should include the conduct of a going business. The case comes under our decision in *Blair* v. *Wilson Syndicate Trust* (C. C. A.), 39 F. (2d) 43. We agree with the Board that the Guitar Trust Estate was not an association."

This shows that in the Fifth Circuit, as in the First, the rules being applied and the results being obtained are in conflict with those in the Seventh Circuit. The same is

true in the Ninth and Tenth Circuits, as shown by the following cases.

In *Commissioner* v. *Combs, et al.*, April 11, 1935, ... Fed. (2d) ....., the Circuit Court of Appeals for the Ninth Circuit, affirming the Board of Tax Appeals, held that there was no "association" where two men, in order to raise funds for the development of an oil lease, created a trust and sold shares of beneficial interest therein representing 25% of the production of the oil well. After developing and operating the well for two years, the trust was terminated by sale of the property. The Court said:

> "Inasmuch as the purpose of the act is to treat associations, corporations, joint stock companies and insurance companies on a basis distinct and separate from that applicable to trusts or copartnerships, it is clear that while a trust may be organized so that the trustees can do business, their powers, duties, obligations and methods of doing business and the relationship of the trustees to the beneficiaries, must in some degree correspond to the similiar duties and obligations of directors and stockholders of a corporation in order to make the trust taxable as an association. * * *. As we understand the respondents they do not question that the trust herein was doing business, but they contend that they do not meet the second test. * * *
>
> "The trust agreement gave the two trustees large powers over the property of the trust similar to those of a board of directors of a corporation, but they had no seal, no principal place of business. There was no provision in the trust agreement for meetings of the trustees or the beneficiaries. The latter had no control over the trustees and no participation in the selection of the trustees or their successors. * * *
>
> "The respondent points out that the trust agreement made no provision for the election of trustees annually or otherwise. Upon the death, resignation

or refusal of one to act, the other was authorized to act alone. There were no corporate officers, no by-laws, nor corporate or association name. While the question involved is a close one not free from difficulty we conclude that the Board of Tax Appeals was right in holding that the organization was not an association within the meaning of the Revenue Act but rather that it was a trust, taxable as such."

In *Commissioner* v. *Brouillard*, April 4, 1934, 70 Fed. (2d) 154, certiorari denied October 8, 1934, under title of *Helvering* v. *Pryor & Lockhart Development Company*, ... U. S. ....., affirming the Board of Tax Appeals, the Circuit Court of Appeals for the Tenth Circuit held that three oil development enterprises, which engaged in substantial and varied activities, were taxable as trusts and not as associations. In its opinion, the Court said:

"Where an entity of this kind resembles a corporation in some respects and that of a partnership in others—that frequently being the case—the features of similarity should be compared and the marks of dissimilarity contrasted. The resemblances should be balanced. It should be determined by that method the one to which the enterprise is predominantly akin in the method, mode and form of procedure in the conduct of its business. If it be a corporation, it falls within that category; if a partnership, it should be placed in that class and should be taxed accordingly.

"The fact that a group associate themselves together for the purpose of engaging in business for profit does not necessarily mean that they must be taxed as an association. That is not the decisive consideration. * * * It is persuasive that Congress intended to tax as a corporation only partnerships conducting their business after the method and form of a corporation, with the economic advantage therefrom, regardless of whether the business is conducted for profit. * * * The facts just canvassed demonstrate

that the method, mode and procedure of each of these entities in the conduct of its business was strikingly different and substantially dissimilar from that usually employed by a corporation. The system and course of procedure approximate much more closely that of an ordinary partnership among personal friends reposing full confidence in each other. The resemblances predominate strongly in favor of a trust. Consequently, the entities should have been taxed as trusts, not associations."

The significant characteristics of the three enterprises before the Court in the *Brouillard* case may be briefly stated as follows:

Iowa-Burk Syndicate.—About 110 persons contributed a capital of $30,000.00 to a trust, organized under a written instrument, for the development of oil wells upon property covered by a lease in which a one-half interest was transferred to the trustees. Certificates of interest were issued, as provided in the trust agreement, but not to all of the contributors. Under the authority of the trust agreement, the trustees, chiefly through one who acted as a manager, procured the drilling of three wells, borrowed money for that purpose, operated the wells for a few months, and then sold the property. No officers were elected and no formal meetings of trustees or beneficiaries were held, except that the beneficiaries were called together to determine whether the lease should be sold, and the attorney for the purchaser required the approval of all members of the Syndicate for the sale. The provision of the trust agreement, that the beneficiaries should meet to elect new trustees as soon as the capital of $30,000.00 had been raised, was not acted upon.

Shepherd Syndicate.—An interest in an oil and gas lease, one-half of which was owned by a corporation, was trans-

ferred to trustees with authority to manage and develop the property. About ten persons subscribed to the capital of the trust, which, however, they did not contribute but which was merely charged against them and deducted from their shares of the income. The corporation which owned the one-half interest in the lease drilled wells, pumped and sold oil, and furnished to the trustees monthly statements for their half of the expenses and income. The duties of the trustees consisted of checking the statement, paying expenses, and distributing dividends to the beneficiaries. One of the trustees acted as manager.

Pryor and Lockhart Development Company.—An oil and gas lease was assigned to a single trustee, acting under a trust agreement. About fifteen persons contributed capital. The trustee procured the drilling of six oil wells on the trust property by an agreement with drilling contractors, and also arranged for the drilling of two wells by the same contractors upon the property of two other owners. The oil produced from the trust property was sold to two corporations, who made payment semi-monthly to the trustee. After paying current expenses, the trustee distributed the net income among the beneficiaries, using the employees of a partnership of which he was a member. The trustee also employed a superintendent and pumper. There were no meetings of the beneficiaries and no attempt by the beneficiaries to control the funds. The trust had no directors nor officers.

The enterprises under consideration by the Circuit Court of Appeals for the Tenth Circuit in the *Brouillard* case, employed modes and procedures and form of organization which were certainly no less similar to those characteristic of incorporated bodies than those presented in this case. Activities carried on by those syndicates were much more

extensive and much more equivalent to the conduct of a business than those of the Lake View Land Association.

Consequently, the decision here under review is clearly in conflict with that of the Circuit Court of Appeals of the Tenth Circuit, as well as wholly irreconcilable with the principles stated in the opinion of that Court, as quoted above. There is a similar conflict with the decisions and opinions of the Circuit Courts of Appeals in the First, Fifth, and Ninth Circuits, as well as in the Tenth. The Supreme Court should therefore grant this petition for certiorari.

(3) In the Seventh Circuit Itself, No Consistent Rule Is Being Applied.

Recognizing that this Court is now concerned only with the instant case, and not with any errors which may have been committed in prior cases, it still seems that the result in the present case can be adequately comprehended only in the light of the prior decisions of the same Court on the same question. It is submitted that the inconsistencies and contradictions shown by the opinions and decisions in those cases will demonstrate that the Circuit Court of Appeals for the Seventh Circuit has been applying to this question a wholly erroneous conception of the governing rule of law. The natural result is the erroneous decision in this case.

We submit that there is no proper ground of distinction between the present case and the decision of the same Court in *Tyson*, et al., *Trustees of the Zenith Real Estate Trust* v. *Commissioner*, December 9, 1931, 54 Fed. (2d) 29, reversing 21 B. T. A. 656. That was the first decision upon this question by the Circuit Court of Appeals for the Seventh Circuit. The trust there involved had been organized

by four associates, three of whom were trustees, to acquire certain real estate which was occupied by a single tenant under a net lease, obligating the tenant to pay all taxes, insurance, etc. An agent was appointed by the trustees to collect the monthly rentals and see that the tenant complied with its obligations. During one of the taxable years involved, the property was sold by the trustees at a substantial profit. Holding that this trust was not taxable as an association, the Court said in its opinion:

> "Both counsel cite *Hecht* v. *Malley*, 265 U. S. 144, 44 S. Ct. 462, 464, 68 L. Ed. 949, to support their positions. Aside from the fact that it is a Supreme Court decision, we see little reason for the emphasis placed upon this holding. The question there decided is not the one here presented. It is true, the court was there considering a tax (excise), and the taxpayer, as here, was a Massachusetts trust. But here the similarity stops. 'Doing business' was the test for the imposition of the excise tax, not the character of the instrumentality that transacted the business. Moreover, to be taxable, the entity was required to be a 'corporation, joint-stock company or association, now or hereafter organized in the United States for profit.' There was not, as here, two sections of the revenue act to be construed; one covering corporations (including associations), and another covering trusts. Obviously, as the Congress in the revenue acts under consideration dealt with both entities and provided different tax rates for each, it could not have intended the term 'association' to have been synonymous with the word 'trust,' as that term was used by it. • • •
>
> "Our question then is, When is a Massachusetts trust an association under these acts, and when is it a trust? Probably the best test is to be found in the activities of the entity. One could readily conceive of a Massachusetts trust being possessed of powers and so exercising them that for taxation purposes it should be called a corporation. • • • Like-

wise, it is easy to conceive of a Massachusetts trust so designed and so purposed as to be considered a trust as that term is used in the revenue acts."

When the same question was next presented to it, in *Tyson, et al., Trustees of Chicago Real Estate Trust v. Commissioner*, Dec. 15 1933, 68 F. (2d) 584, certiorari denied 292 U. S. 657, the Court explained its prior decision as follows:

"The case of *Tyson, et al. v. Commissioner*, 54 F. (2d) 29, 31, was decided by this court shortly before the decisions were handed down by the Board in these cases, and the Board discussed it at length in its opinion. * * * This court in holding that the trustees should be taxed as fiduciaries rather than as an association stated, 'In short, the investment was one which provided with reasonable certainty for a sure and fixed income *without other care or supervision*.' (Italics ours.) Using this as a test, we think it can not be said that petitioners in the case at bar are simple fiduciaries. It seems obvious that the duties connected with their investments involved considerable care and supervision."

As shown by the opinion of the Court, the activities of the Chicago Real Estate Trust were much more extensive than those of the Zenith Real Estate Trust. This was apparently the controlling reason for the decision of the Court that the Chicago Real Estate Trust was taxable as an association. The opinion states:

"The first question then is, were the petitioners associated together for the purpose of carrying on a business enterprise, or were they merely holding property for the collection of the income and its distribution among the beneficiaries of the trust? * * *. With all these facts present, surely it cannot be said that the trustees were a mere conduit through which the income from the properties passed for distribution to

the receipt holders practically without activity on their part. We therefore conclude that the trustees were engaged in sufficient activities to warrant our holding that they were carrying on a business enterprise, hence taxable as an association."

Referring to the contention of the petitioners, that even if they were carrying on a business they would be properly subject to tax only if, in addition, they were substantially similar to a corporation in other essential characteristics of form and procedure, the Court said:

"That the organization of the trustees was of a very loose and informal character we think is not sufficient to take them out of the classification contemplated by the administrative regulations cited. Even though no formal meetings of the trustees were held, they had adopted a regular practice for the administration of their trust. At regular intervals the trustees living in Chicago would go over the accounts which were kept in the offices of their agent, and determine what dividends should be paid to the receipt holders. They would then prepare a dividend resolution and send it to the trustees who lived in Boston for their approval. The various leases on properties owned by the trustees were signed by all of them individually, with some designation of their trust capacity. Where matters arose which in the judgment of the agent needed to be considered by all of the trustees, they were handled by correspondence. Although the receipt holders never exercised their right to call meetings, they received printed annual statements shortly after the close of each fiscal year, and were thus kept in touch with the activities of the trust. The receipts evidencing their beneficial interest in the trust were engraved ones with transfer forms on the back. The trustees employed a regular transfer agent to take charge of and record all transfers of receipts. It is true that neither the trustees nor receipt holders ever drew up a code of rules or by-laws for the government of the trust,

but such action seems entirely unnecessary in view of the comprehensive nature of the trust agreement under which they were organized in the first place. We think that these facts are sufficient to warrant our classifying petitioners as a quasi-corporate organization in form and procedure and as such taxable as a corporation."

A fair analysis of this language shows that the conclusion that the trust was "a quasi-corporate organization in form and procedure" was based entirely upon the following characteristics:

(1) The trustees had adopted "a regular practice for the administration of their trust."

[It is difficult to conceive of any trust which could be administered without the adoption of some routine or practice.]

(2) The accounts would be examined by the trustees and the amount of dividends to be distributed would be determined by resolution of the trustees.

(3) Leases were made by the trustees, "with some designation of their trust capacity."

(4) Matters requiring consideration by the trustees were handled by correspondence.

(5) The receipt holders received printed annual statements and were thus kept in touch with the activities of the trust.

(6) The receipts evidencing the beneficial interests in the trust were engraved forms, with transfer forms on the back, and a regular transfer agent was employed to take charge of and record all transfers.

(7) A code of rules or by-laws was "unnecessary in view of the comprehensive nature of the trust agreement."

It is submitted that the issuance of receipts evidencing the beneficial interests is the only one of the foregoing

forms or methods of procedure which in any way resembles those characteristically employed by corporations. The Court has not said, and we believe would not be willing to say, that this characteristic alone would warrant classification as a corporation rather than as a trust for purposes of taxes. All the other features mentioned are obviously appropriate to a typical trust.

While the Court said that a code of rules or by-laws was "unnecessary in view of the comprehensive nature of the trust agreement," it might be argued with equal foundation that such rules or by-laws were unnecessary because the character of the enterprise was fundamentally different from that of a corporation. In many of the reported cases, the trust agreements have provided for meetings and elections, for shares of different classes, with different rights and preferences, and have otherwise served the functions of by-laws, but that was not true in the case of the Chicago Real Estate Trust. The Trustees were a self-perpetuating body, with no necessity for periodical elections, and with their powers and functions largely determined by the general law of trusts and only as to certain specific details governed by the trust agreement. Under these conditions, it is difficult to see how the provisions which are typical of corporate by-laws could have been appropriately adopted for that trust.

It may also be questioned whether the opinion was correct in stating that the Chicago Real Estate Trust was "a typical Massachusetts trust." The voluminous litigation and literature relating to typical Massachusetts trusts indicate that they frequently, if not ordinarily, employ many forms and methods of procedure which are characteristic of corporations and which were not employed by the Chicago Real Estate Trust nor by the Lake View Land Association.

The failure of the Circuit Court of Appeals for the Seventh Circuit to recognize the significance of the employment of corporate methods and forms is even more clearly demonstrated in its later opinion in *Reinecke* v. *Kaempfer, et al.*, June 26, 1934, 72 F. (2d) 469, certiorari denied Jan. 21, 1935, ... U. S. ..... The Court there held that a family trust, conducting a retail seed and bird store, was subject to capital stock tax as an association, and in its opinion said:

> "In these references to a similarity to corporate enterprises it surely was not intended to hold that, in order to constitute a statutory taxable association of an aggregation of persons who are not partners, there must be present all the elements and conditions essential to corporate existence. If this were so, then the entity would be a corporation and no such question could arise. A manifest distinction is the ultimate fact that the entity sought to be taxed is *not* a corporation. It must therefore be different from a corporation. The business here was, during the taxable years, carried on by these trustees in much the same manner that it had just before been carried on by the corporation; the same persons were in charge, and no difference whatever is pointed out in the manner of its conduct. The trustees, as the directors before them, met occasionally to discuss the business, and minutes of such meetings were kept; annual audits were made; merchandise was bought and sold; and so far as anything to the contrary appears there was no fundamental change in the general nature of the business during the near three-fourths of a century since it was founded and carried on with apparent success. It is plain that from its inception the business was carried on for profit. The powers and duties of the trustees in the carrying on of the business were not substantially different from those of the antecedent corporate directors. * * *

"We are satisfied that the similitude referred to is not in those essentials which distinctly stamp the entity as a corporation, but rather in the business carried on and the manner of its transaction. This entity carried on its business in substantially the same way that a corporation would have carried it on. It regularly bought and sold merchandise for the purpose of realizing profit thereon; it constituted the persons to carry on the business, and even made provision for exemption of the trustees from personal liability for trust obligations, much as in the case of business corporations."

A clearly inconsistent attitude was expressed in *Commissioner* v. *Morriss Realty Co. Trust*, C. C. A. 7, January 2, 1934, 68 Fed. (2d) 648, affirming the Board of Tax Appeals. There the Court held that there was no association in the case of a family real estate trust, which subdivided tracts conveyed by the original grant and several other tracts subsequently purchased by the trustees, sold lots on installments, erected houses, the cost of which was in part obtained from mortgages, and sold such houses on time contracts. The Court said:

"When these Regulations upon which the Commissioner relied are examined, it must be observed that to be taxed as a corporation the trust must be one which 'acts or does business in an organized capacity' (1502), and where the trustees 'are associated together in much the same manner as directors in a corporation for the purpose of carrying on some business enterprise,' (1504). • • •

"There is scarcely any trust which, in its administration, does not necessarily involve the doing of some kind of business.

"To give the Regulations and the Treasury Decision the construction contended for by the Commissioner in this case would have the force and effect of nullify-

> ing the express provisions of the statute providing that trusts shall be taxed as individuals. The expression 'for the purpose of carrying on some business enterprise' as used in the Regulations and Treasury Decision referred to, and which was undoubtedly designed to comply with what the Supreme Court said in *Hecht* v. *Malley, supra,* must be limited to trusts which carry 'on some business enterprise' for the purpose of gain or profit and under some type of corporation organization."

Two other decisions were rendered by the same Court without any attempt to express any principles upon which they rested. With both of them the present decision appears to be in distinct conflict.

The case of *Commissioner* v. *McCormick,* et al., C. C. A. 7, Jan. 24, 1934, 68 F. (2d) 653, was in many respects similar to the present case of the Lake View Land Association, although a much larger enterprise was there involved. Three brothers, owning a large office building, conveyed the property to themselves as trustees, and issued certificates of beneficial interest which were hypothecated to secure a loan. The trust indenture was involved and lengthy. The management of the property was delegated to an agent, who managed other properties of the same owners. Without any discussion of rules or standards, the Court said:

> "Looking to the substance rather than the form of this trust, to its activities rather than to its potentialities, we have no hesitation in saying that for purposes of taxation it was a trust and its income tax should be assessed on that hypothesis."

Commissioner v. *Duckwitz,* C. C. A. 7, February 9, 1934, 68 Fed. (2d) 629, involved the same Iowa-Burk Syndicate which was before the Circuit Court of Appeals for the

Tenth Circuit in *Commissioner* v. *Brouillard*, 70 Fed. (2d) 154, certiorari denied ..... U. S. ..... In holding that that syndicate was not an "association," the Circuit Court of Appeals for the Seventh Circuit said:

> "The appeal presents a borderline case which turns on the existence of sufficient facts to support the findings of the Board of Tax Appeals. * * * In reaching this conclusion we are adhering to the rule previously announced by us in *Tyson* v. *Commissioner*, 54 F. (2d) 29, and *Tyson, et al.* v. *Commissioner*, decided December 15, 1933, which makes the decision in each case turn on the facts of said case. In the case before us the facts were sufficient to support the Board's finding respecting action of the group and we therefore must accept it."

The Court's description of the Iowa-Burke Syndicate could be applied almost verbatim to the Lake View Land Association, and the Court has furnished no explanation for the contradiction in the results. In the language of the opinion in the *Duckwitz* case, describing the former trust, we have interpolated the changes necessary to apply to the Lake View Land Association, as follows:

> "If we read the evidence and the trust agreement together it seems tolerably plain therefrom that a small group of people in Charles City, Iowa, [two men in Chicago] planned a simple and inexpensive method of handling a small venture in Texas oil speculation [an apartment house investment in Chicago].
>
> "A single tract of ten acres [lot and building] was the field of their operation. Nowhere was there a suggestion that the trustees or members contemplated any oil mining [real estate investment] activities outside of this tract. Those who conceived the project planned that this local group, who were willing to back their hopes with a contribution sufficient to drill an oil well [purchase the property], should divide the profits

> [income]. The contributions of each were so small that a conveyance of a fractional interest in the real estate would have been cumbersome and impractical. [Their attorney advised them against carrying the title in their individual names.] Confidence and trust in one of the members led to the deposit of money with him, which in many instances was paid without his giving the payer any written document whatever. [The active management of the property was entrusted to one of the parties, who was in that business.]"

There can be no question that the Circuit Court of Appeals for the Seventh Circuit has wavered between two wholly inconsistent attitudes and has rendered conflicting decisions without even attempting to reconcile the results with the principles stated by the Court at one time or another. Its present decision, being opposed to the rules established by the Supreme Court and being in conflict with the decisions of the Circuit Court of Appeals, in the other Circuits, as well as contrary to its own decisions in other cases, should be reviewed.

(4) A Decision by the Supreme Court is Urgently Required, Because of the Existing Uncertainty and Inequality.

This Court has apparently recognized the need for review of the question here involved, since it has granted certiorari, on May 13, 1935, in the case of *Morrissey* v. *Commissioner*, Dkt. No. 834, which presents the same question. The Solicitor General for the United States also recognizes the need, since he has authorized the filing of a petition for certiorari, on May 27, 1935, in the case of *Helvering* v. *Coleman-Gilbert Associates*, seeking review of the decision which has been frequently referred to in this brief. That petition states:

"In the light of such confusion, the question involved is one of general importance, since there are numerous cases now in litigation and in the Bureau of Internal Revenue * * *"

From the preceding demonstration of conflict between the decisions in the various circuits, and of inconsistency in the decisions in the Seventh Circuit, it is manifest that a most unfortunate condition of uncertainty and inequality must result. It remains only to point out that the Circuit Courts of Appeals themselves, in commenting upon the lack of any generally recognized rule of decision in these cases, have persuasively argued that the Supreme Court should take jurisdiction and clarify the situation.

In *Coleman-Gilbert Associates* v. *Commissioner,* Feb. 27, 1935, 76 Fed. (2d) 191, certiorari applied for May 27, 1935, Dkt. Nos. 1003, 1004, the Circuit Court of Appeals for the First Circuit said:

"It was left for the courts or the Treasury Department by Regulations to determine what organizations are included within the term 'associations.' As yet the Supreme Court has not laid down any absolute test. * * *

"There are numerous decisions of the Board of Tax Appeals and Circuit Courts of Appeals in review, without laying down any definite line of demarkation between an association and a pure trust. * * * In any event, the decisions are seemingly in a hopeless state of confusion. * * *

"It would serve no useful purpose to attempt to analyze all the cases that have been decided by the Board of Tax Appeals and the Circuit Courts of Appeals involving this question. The lack of a conclusive test will sufficiently appear in the following cases in which the Board of Tax Appeals has been sustained in holding a trust was an association: * * * and in

the following cases in which the court has either reversed the Board in holding that the trust was an association, or has approved the Board's finding that the trust was not an association. * * *

"From the decisions of the Board of Tax Appeals and the several Circuit Courts of Appeals, it is impossible to mark out any definite pathway to follow in every case. The only conclusion is that each case must depend on its own state of facts."

The same Court said, in *Commissioner* v. *Kelley*, December 1, 1934, 74 Fed. (2d) 71:

"The decisions in which the courts have attempted to draw the line of demarkation between a trust and an association, have left it very vague and difficult of application. No absolute rule for such classification has yet been laid down by the Supreme Court, and the Regulations of the Treasury Department, 74, Art. 1314, cannot be held to be exclusive in defining the line between a trust and an association."

In *Commissioner* v. *Combs, et al.*, April 11, 1935, ... Fed. ....., the Circuit Court of Appeals for the Ninth Circuit said:

"The question as to whether or not organizations are taxable as associations under the Revenue Act is one that has been frequently before the courts and is not free from difficulty. * * * We think it unnecessary to enter into an extended discussion of the various decisions of the courts of appeals dealing with the question, or to attempt to establish the proper rule for determining the question of tax liability."

In *Morrissey* v. *Commissioner*, Jan. 7, 1935, 74 F. (2d) 803, certiorari granted May 13, 1935, the same Court said:

"As to the contention that 'doing business' is not controlling or relevant, this court in *Twin Bell Oil Syndicate* v. *Helvering*, 70 F. (2d) 402, at page 407

(C. C. A. 9), after quoting from its opinion in the *Trust No. 5833, Security-First National Bank* v. *Welch*, 54 F. (2d) 323 (C. C. A. 9) said: 'There is ample additional authority for the proposition that the "business" test is now paramount.' • • •

"It is now well settled that beneficiary control is not a requisite to the taxability of a trust as a corporation. *Twin Bell Oil Syndicate* v. *Helvering, supra.*"

From the decisions which have been discussed under this and the preceding points, it is obvious that there is no clearly established or generally recognized rule of decision upon this question. The different Circuit Courts of Appeals have formulated entirely different standards for measuring the resemblance of a trust to a corporation, and in the Seventh Circuit no definite standard or rule has been expressed at all. Consequently, under essentially similar circumstances, tax liability is being determined upon one basis in one Circuit and upon an entirely different basis in other Circuits. In the Seventh Circuit, a taxpayer is almost entirely without guidance as to the standards by which his tax liability will be measured. The rules which were announced many years ago by this Court are not being applied.

That large numbers of taxpayers and large amounts of taxes are affected by this uncertainty and confusion is demonstrated by the large number of cases which have been decided by the various Circuit Courts of Appeals, only a few of which have been mentioned in this brief, and by the even larger number which have been and are being decided by the Board of Tax Appeals. Until an intelligible rule is established, almost any decision of the Board of Tax Appeals or of a District Court will require an appeal to the Circuit Court of Appeals, and almost any decision of a Circuit Court of Appeals will justify a petition for cer-

tiorari to this Court. Great hardship has already resulted because the situation has not previously been clarified, and a review of the question by this Court should no longer be delayed.

Conclusion.

It was obviously the purpose and intention of Congress that the tax burdens imposed upon business corporations should likewise be shared by those unincorporated enterprises which were essentially similar to a corporation in form of organization and mode of operation. The attitude of the Supreme Court in *Hecht* v. *Malley* and in *Burk-Waggoner Oil Association* v. *Hopkins*, is completely in accord with this legislative purpose. In the other Circuits, this legislative intention has been quite generally recognized, but it has been ignored and defeated by the Circuit Court of Appeals for the Seventh Circuit. In the present case a trust which has no substantial resemblance to a corporation in form or in operation has been subjected to the corporate tax. That decision should therefore be reviewed and reversed by this court.

Respectfully submitted,

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